The Facts About Canada's Banks

Bank Loans Convert Credit of Borrower Into Spendable Money . . . The Fact That Banks Have Limited Power to Issue Own Notes Stressed Again . . . Letters Received Tell About Actual Cases Where Bank Loans Enabled Borrowers to Turn Substantial Profit

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Canada's Chartered Banks decided to tell the plain facts about Canadian Banking in a series of Radio Broadcasts, with a view to dispelling certain misapprehensions concerning the functions and practices of Banking in Canada. The Public Relations Adviser of Canada's Chartered Banks broadcast the sixth address from Edmonton, Alberta, on October 12th., 1937. The text of that address is contained herein.

The Facts About Banking in Canada

IN this broadcast on behalf of Canada's Chartered Banks I want to get back to that utterly mistaken idea that banks make money out of nothing. Critics of the banks will tell you that banks lend by creating credit and that they create the means of payment out of nothing, that when they build a building it costs them nothing and that when they pay taxes it costs them nothing. These statements are absolutely untrue.

When a bank makes a loan just exactly what is it that the bank does?

Here is the answer—It takes the note of the farmer or manufacturer or the bond of the Government, and places an equivalent amount to the credit of the said farmer, manufacturer or Government, allowing of course for a rental on the money.

In other words the bank assumes an obligation to pay that amount to the farmer, the manufacturer or the Government.

Since that obligation is one that *must* be met — and in actual practice *is* met — it is a very real thing.

The transaction creates a credit on the books of the bank but the *means* of *payment* which the banks are charged with creating out of nothing consists of resources of the bank — in the last analysis, cash.

Moreover, it should be borne in mind that in all lending transaction by a bank it is the borrower who starts the process — he goes to the bank and asks for a loan, generally for a specific purpose, out of which he expects and intends to make a profit for himself over and above the bank charges. The bank does not go to him — *he* goes to the bank.

What the bank really does, in effect, is to *convert* the credit of the borrower himself into spendable money, which he can use for the purposes of his business, paying wages, paying his debts at the country store and meeting other obligations. If a man owns cattle he cannot spend cattle. He cannot pay his debts at the country store with cattle. His ownership of the cattle and his expectation of selling them at a profit to himself are the basis of his credit. When he borrows from a bank on the security of cattle what happens is that the bank converts a form of wealth, which he cannot spend, into something which he can spend and which anybody else will accept.

There is no magic about it and those who contend that a bank can create money or the means of payment out of nothing — are entirely wrong. The function that the bank performs, as we have stated, is to *convert* the credit of the borrower into a form in which he can spend it.

Without a bank the farmer possibly could buy seed in the spring, hire help through the growing season and harvesting, and purchase supplies for his family in the meantime on credit — paying these debts from the sale of his crop in the fall. However, common sense tells us that the seed merchant, the farm labourer or the country store keeper could not get very far on this basis, for they could not pass on to the people, from whom they in turn buy goods or services, the obligations which they have received from the farmer.

Why is this so?

For the reason that, be the farmer's credit ever so good, how could scores of people look into his integrity and his financial worth, as they would require to do before taking his promise-to-pay. Instead, the bank looks into the farmer's affairs, accepts the risk, lends him the money and enables him to pay cash.

If it were otherwise and if banks created the means of payment out of nothing, why has it been necessary through the centuries to find people, called shareholders, ready to put their money into the banking business in exchange for a fair return? If no basis is required for what the bank does, the business of banking should be an amazingly profitable business — but it is not. The fact that it is not an amazingly profitable business is a simple matter of record, as we have shown in our broadcasts.

Some of our listeners have asked that I say more about note circulation—that is, about the powers of a bank to issue notes. The request has been prompted by the utterly fantastic idea that a bank can, say, erect an expensive branch office building for nothing by issuing its own notes. A bank simply cannot, as has been suggested, issue a bunch of specially numbered bills, pay them out to contractors and others, and then cancel them when they come back.

Let me say to you again that no such thing can possibly happen, for the bank must give the holder face value for its notes when he presents them. Moreover, I have shown you that there are very definite legal limits upon the amount of notes that a bank can issue. A bank's notes are a debt owed by the bank to the person who holds **them—a debt redeemable in *cash* on demand.**

As a matter of fact, a bank's notes are the very first charge upon its assets—that is to say in case of trouble a bank's notes have to be paid off before a single cent can be paid on any deposits or on any other debts owed by a bank. To make doubly sure of this there is a fund in the hands of the Dominion Minister of Finance, known as "The Bank Circulation Redemption Fund."

This is money paid in by each of the banks to the Minister of Finance at Ottawa, amounting to five per cent on the average amount of Chartered Bank notes outstanding. This money is in the nature of a pool and would all be used, in case of need, towards paying off the notes of any bank. Surely all of this should finally squelch the idea that a bank has unlimited power in the matter of issuing its bills.

In any case, as I have told you before, the right of issuing notes is being steadily, year by year, taken away from the Chartered Banks and vested in the Bank of Canada. In order to obtain Bank of Canada notes or bills for use as currency the Chartered Banks have to buy them. Every dollar in notes and every dollar of other bank obligations must always have behind it a dollar of assets. Let me stress, once more, that every obligation of a Chartered Bank is payable in *cash*.

Some supposedly great authority is quoted as having said that if all bank loans were paid all deposits would disappear and there would be no money in existence. I don't think that many Alberta people are stampeded by such statements.

It is equivalent to saying that if every sea were drained dry there would be no ocean liners. If every bank went out of existence tomorrow there would still be wealth but the job of marketing that wealth would take us back to the dim, distant days of barter. Nothing is gained at any time by such extreme statements.

You have been told that when a bank makes a loan and takes security, the bank then uses that security as if it were its own. Such a statement is 100 per cent false. The security lodged with the bank remains the property of the borrower and all the records of the bank prove that fact. He can call for his security to be produced and shown to him at any time. Such security does not appear in the bank's balance sheets at all and when the loan is repaid the security is handed back to the borrower intact.

Some of our critics plunge into very deep water when they draw conclusions from the statement that every dollar that comes into circulation represents a debt on which somebody must pay interest. That

statement is used to convey to you a sinister impression, an entirely false idea of what money really is and does.

To illustrate in the plainest of everyday terms let us start from the beginning:

I go into the bank and I borrow $1,000 on which, naturally, I have to pay rent, or if you prefer, interest.

The bank gives me, in exchange for my note, $1,000 in bills. I have got $1,000 of money, on which interest has to be paid because the bank is giving me a service.

Why do I borrow the money?

I was going to use it in a deal, expecting to make a profit for myself; or I wouldn't have borrowed the money at all.

Very well; I carry out the deal successfully. I repay the bank the $1,000 I borrowed, and I have a profit, say, of $100, which I put to my credit in the bank.

You will see by the use of this borrowed money on which I paid rent, I have increased my own resources by $100, and the bank has received back its $1,000.

When you multiply that thousand-dollar borrowing of mine, my use of the money and my profit, time after time, you see what is happening continuously throughout the year in the business world and you see that the interest is not any strangling charge as has been represented to you. You pay rent, and you make a profit out of it—whatever the nature of your business may be.

It is a continuous, revolving process—in which the dollar you use is not dead-weight debt at all, but productive money. There are times, however, when *some* of it may become temporarily dead-weight debt. To illustrate such a case, let us say that through drought or misfortune I suffer a loss for a season—say my deal has not been successful—and I lose a part of my borrowed $1,000.

In these cases, what I have lost *does* for the time being become dead-weight debt. But with a better season and better prices and better business I have a chance to recover my losses and repay. By far the greater part of the dollars that are issued are not dead-weight debt as you have been so often told; there is nothing sinister in the manner nor in the purpose of their issue, nor in the work that they do; they are, in fact, productive money, constantly adding to goods and services and increasing the world's store of new wealth.

That is all there is to bank money. Bank loans are really constructive and productive; and the deep, dark hocus pocus with which

critics seek to surround it is recognized, by folks of practical experience, as simply transparent nonsense.

Since we started broadcasting on behalf of Canada's Chartered Banks I have received many letters from Alberta people: I have before me one of them, which gives an instance of a large-scale farmer who had occasion to borrow $5,000 to purchase feeder cattle.

This farmer says: "When I borrow money I estimate my prospective profit very carefully and, if I do not see where I am going to make interest charges and a substantially higher profit for myself I do not borrow the money. Without a bank loan I could not possibly have financed the purchase of the cattle and, further, I feel that the bank's profit is small and mine proportionately large. I consider that I should assume all the risk of loss for the sake of this higher prospective profit. My borrowing is intelligent borrowing from a purely individual and selfish standpoint. I had a similar loan, on which the interest charges amounted to about $100 some time ago. On this loan I realized a net profit of more than $2,000 because I was able to feed all of my coarse grain and to realize in the neighborhood of ninety cents a bushel when prices were in the neighborhood of twenty to thirty cents a bushel."

I have another Alberta letter, in which a farmer tells us that he had twenty hogs and, being short of feed, wanted to sell them. He was offered $200 for the twenty hogs and did not want to let them go at that price, so he went to the bank and borrowed $50 only. This enabled him to hold the hogs and feed them a while longer, with the result that he eventually sold them for $300 instead of the $200 he had been offered. In other words he borrowed $50 from the bank, the bank made a gross revenue of about $1.75 but the farmer made a straight profit of $50.

I have a letter before me also which appeared in the Calgary Herald from a Milk Producers' Association in the vicinity of Calgary. It reads in part: "We are hearing a good deal about banks these days. I do not profess to know much about banks or the banking business but I do not that, if it had not been for the banks last fall, I, along with many others, would have been forced out of business." These are but a few examples taken at random from a large quantity of our mail.

In earlier broadcasts I have told you that deposits in the banks are the basis upon which banks can make loans. Let us demonstrate its truth.

Suppose a bank started business with $50,000 in cash and lent that amount to various borrowers. Then suppose each borrower drew out the amount lent to him, in cash, and each person to whom he paid this money put it in a sock, kept it under his mattress or hid it behind the clock, so that none of it came back to the bank in the form of deposits. As the bank has no cash in its vault the bank dare not make another loan because it could give no cash to the new borrower.

We can go on converting borrowers' assets into spendable form, *i.e,* making loans, only if the depositing public are willing to entrust their funds to us. It is the confidence of the people in banks and their willingness to leave their money on deposit that enables a bank to lend money and serve the community.

How, therefore, can it be said that we have usurped the right to monetize credit? As we have shown, it is the individual who in the first place possesses the credit; he asks the bank to convert that credit into money he can spend. The bank only does it on his request.

Now I have an announcement to make. This is the last of our broadcasts, at least for the time being. In one of our broadcasts we said that some of your Alberta branch bank Managers might be heard in this series. Instead, I incorporated in my talks with you, much material which came to me direct from them.

We told you in starting our talks that we would be non-political and non-controversial and would state to you nothing but the unvarnished facts about Canada's Chartered Banks and the work they do. This is exactly what we have done. There is no mystery about Canadian banking, other than the mystery created by critics who are not well informed.

We are doing an honest business and have nothing whatever to fear from the fullest disclosure. Four million depositors have confidence in Canada's Chartered Banks. Were it no for that confidence in the honour and integrity of Canada's Chartered Banks, no loans could be made at all.

We wish to thank our listening audience for the many encouraging letters and messages they have sent in. Our talks have all been put into pamphlet form, and if you wish to have them, any branch bank Manager will be glad to give them to you and to talk over with you any of the matters with which we have dealt.

Theorists never run out of theories — but facts are stubborn things. Our story stands for your fair-minded consideration. We leave it to you with confidence.